

## Chapter 8

### COMPARISON WITH OTHER TAX REFORM PLANS

Over the past several years many proposals for tax reform have been advanced by members of the U.S. Congress. These include proposals for a pure flat tax, a modified flat tax, a tax on consumed income, and a value-added tax. All of these plans share common objectives: to broaden the tax base and lower rates and thereby make the tax system fairer, simpler, and more neutral in its impact on the private economy. The same objectives motivated the Treasury Department study.

The Treasury Department proposals for tax simplification and reform combine many of the best features of these Congressional plans for tax reform. They go further in measuring taxable income comprehensively and consistently at both the corporate and individual levels. They deal more completely with problems of tax shelters and abuses -- a growing threat to the tax system -- and address in greater detail the need to simplify the income tax. In short, though the Treasury Department plan draws heavily on the pioneering efforts by many members of Congress and by others, it goes further in achieving the mandate to design a tax system that is broad-based, simple, and fair.

Two of the earliest and most detailed of the congressional proposals are those by Representative Jack Kemp and Senator Robert Kasten for a "Fair and Simple Tax" (S. 2948; H.R. 6165) and by Senator Bill Bradley and Representative Richard Gephardt for a "Fair Tax" (S. 1472; H.R. 3271). These bills include most of the specific proposals for reform contained in the other bills offered by members of Congress. This chapter compares the most important features of the Treasury Department proposals with those of the Kemp-Kasten and Bradley-Gephardt plans. More detailed and more comprehensive comparisons with these and other congressional plans are provided in the appendices to this chapter.

Like the discussion of tax reform proposals in chapters 5, 6, and 7, the comparison of the Treasury Department, Bradley-Gephardt, and Kemp-Kasten proposals is divided into provisions that affect virtually all individuals, regardless of whether they have important amounts of capital or business income (section I), those that pertain almost exclusively to the basic taxation of capital and business income, including the tax treatment of retirement savings and the taxation of corporations and partnerships (section II), and those that pertain to specific industries and tax shelters (section III), and those that pertain to other tax issues, including the taxation of transfers and provisions that are currently planned to expire (section IV).

## **I. Individual Income Tax**

### **A. Income Tax Rates**

One of the primary objectives of the Treasury Department study of tax simplification and reform has been to broaden the income tax base enough that a given amount of revenue can be raised with substantially lower tax rates than under current law. This important objective is shared by the Kemp-Kasten and Bradley-Gephardt proposals, and, indeed, by all of the proposals for fundamental tax reform that have been introduced in the Congress.

Under the Treasury Department proposals all income of individuals above the tax-free amount will be taxed at three rates, 15 percent, 25 percent, and 35 percent. Real capital gains -- that is, gains after adjustment for inflation -- will be taxed as ordinary income. By comparison, the Bradley-Gephardt proposal will impose three tax rates, 14 percent, 26 percent, and 30 percent. This rate graduation will be achieved by levying the 14 percent rate on all income and surtaxes of 12 and 16 percent on incomes above certain levels. Nominal capital gains will be taxed as ordinary income, without adjustment for inflation.

The Kemp-Kasten proposal contains only one statutory rate, 25 percent. However, 20 percent of "earned income" -- wage and salary income and income from sole proprietorships and farms -- up to the social security ceiling (\$39,600 in 1985), will be exempt from tax. (For this purpose the first \$10,000 of income of single taxpayers and \$15,000 of income of a married couple with income below those levels is assumed to be earned income, even if it is from capital or business. These amounts are indexed for inflation.) That exemption is then phased out (at an income level of \$102,960). Because this exemption is phased out, there is, in effect, a 20 percent rate on earned income up to the social security ceiling, a 28 percent rate over the phase-out range of income, and then a flat rate of 25 percent on income above the phase-out range.

### **B. Fairness for Families**

Under current law, the personal exemption for taxpayers and dependents for 1985 will be \$1,040 per person (allowing for indexation, which begins January, 1985); the elderly and the blind receive an additional \$1,040 exemption. Under the Treasury Department proposals the taxpayer and dependent exemptions will be increased to \$2,000 per person in 1986. The extra exemptions for the elderly and the blind will be folded into an expanded credit for the elderly, blind, and disabled, so that the tax-free amount for the elderly will be increased slightly. The Kemp-Kasten proposal follows a similar approach, raising the taxpayer and dependent exemptions to \$2,000; it will also increase the additional exemptions for the elderly and the blind to \$2,000. The Bradley-Gephardt proposal distinguishes between personal exemptions for the taxpayer and spouse, which it sets at \$1,600 (or \$1,800 for a head of household), and those for dependents,

the elderly, and the blind; the latter are set at \$1,000. The Bradley-Gephardt plan allows personal exemptions to be deducted in computing income taxed at the 14 percent rate, but not for computing income subject to the 12 percent and 16 percent surtaxes.

Under current law the zero-bracket amount in 1986 is estimated to be \$2,510 for individuals, \$2,510 for heads of households, and \$3,710 for joint returns. Under the Treasury Department proposals these amounts will be increased to \$2,800, \$3,500, and \$3,800, respectively. By comparison, the Kemp-Kasten proposal (after indexing to 1986 levels) increases them to \$2,950, \$2,950, and \$3,820, respectively, and the Bradley-Gephardt proposal increases them to \$3,000, \$3,000, and \$6,000. For a family of four filing a joint return and receiving only income from employment, the tax-free amount -- the level of income at which tax liability begins (including the earned income credit) -- would be \$11,800 under the Treasury proposal, \$11,200 under the Bradley-Gephardt proposal, and \$15,675 under the Kemp-Kasten approach. Under current law a family of four will incur no income tax liability until adjusted gross income exceeds \$9,613 (after indexing for the increase in prices projected for 1985).

The Treasury Department proposals retain the indexation of the zero-bracket amount, personal exemptions, and rate brackets that becomes effective on January 1, 1985. Without indexation inflation will continue to give rise to "bracket creep" that causes taxpayers with unchanged real incomes to pay increasingly higher rates of tax. Lack of indexation also allows inflation to lower real tax-exempt levels of income and impose taxes on persons in poverty. Whereas the Kemp-Kasten proposal also retains indexation, the Bradley-Gephardt proposal will repeal it. The Treasury Department and Kemp-Kasten proposals will also extend indexation to the dollar limits of the earned income tax credit.

The choice of personal exemptions and zero-bracket amounts involves conflict between several competing goals. First are revenue considerations. Higher tax-exempt levels reduce revenues and require higher tax rates to reach a given revenue goal. In some proposals there is a tendency to raise taxes more for middle-income taxpayers to accomplish greater reduction at lower income levels.

Second, if personal exemptions and the ZBA are set in such a way that the tax threshold closely resembles the poverty level of income for taxpaying units of various types, a marriage penalty is produced. The marriage penalty occurs because at any level of income two persons living together have lower expenses than two single persons living alone. Thus two single persons living alone at the poverty level have an aggregate tax-free amount greater than a married couple at the poverty level, if the tax-free amount tracks the poverty level. If, on the other hand, the tax threshold for a married couple is set equal to the poverty line, a tax threshold for single persons of only half that amount will fall short of the poverty level of income for a single person.

A third objective is to make adjustments according to family size for ability to pay. Personal and dependent exemptions are the primary means of accomplishing this goal. The Treasury Department plan, as well as the Kemp-Kasten proposal, recognizes the need to adjust personal exemptions for inflation. The Bradley-Gephardt proposal makes no adjustment in the dependent's exemption and, in fact, through lack of indexing allows the real value of current dependent's exemption to decrease.

In its proposals the Treasury Department has attempted to balance the competing objectives of eliminating the marriage penalty, tracking poverty levels of income, not raising the tax on single persons too high relative to that on one-earner married couples, and adjusting appropriately for family size. The Treasury Department proposal, the Bradley-Gephardt proposal, and the Kemp-Kasten proposal will all repeal the two-earner deduction, which is needed less, once the rate structure is less steeply graduated.

### **C. Fair and Neutral Taxation**

If the U.S. tax system is to be made fair and more neutral, the tax base must be defined comprehensively. Base broadening under the Treasury Department proposals comes from three major sources: taxing currently excluded forms of income, curtailment of existing tax subsidies to particular uses of income via itemized deductions, and limitations on existing abuses of the tax system.

**1. Excluded sources of income.** Fringe benefits provided by employers represent substantial amounts of real income that are excluded from the tax base. These are commonly divided into two groups, statutory and non-statutory, to reflect the fact that the former are explicitly excluded from taxation by law, whereas the latter have only been excluded by custom. This terminology is still useful, even though the Deficit Reduction Act of 1984 extended statutory exemption to certain of the non-statutory fringe benefits.

The most important statutory fringe benefit excluded from the tax base is premiums on accident and health insurance provided by employers. Other statutorily excluded fringe benefits include group-term life insurance, dependent care services, and certain living allowances. Under the Treasury Department proposals, most statutory fringe benefits will be taxed, with exceptions or limitations when amounts are small and valuation is difficult. Employer contributions to health plans will be taxed only to the extent that they exceed \$70 per month for an individual employee and \$175 per month for family coverage; these floors will be indexed to protect their real value from inflation. The Bradley-Gephardt proposals and, to some extent, the Kemp-Kasten proposals also include many major statutory fringe benefits in taxable income. Non-statutory fringe benefits (including those recently excluded by law) would not be taxed under any of the proposals.

All three proposals will tax unemployment compensation; the Treasury Department and Kemp-Kasten proposals will generally tax workers' compensation, because it also serves as a wage replacement program. All three proposals will tax income received in the form of scholarships and fellowships, but only to the extent that it exceeds tuition expenses. The increased tax thresholds provided by the higher personal exemptions and ZBA in the Treasury Department proposals will prevent the taxation of most low-income recipients of any of these benefits.

**2. Preferred uses of income.** Major itemized deductions allowed under current law are for state and local taxes, charitable contributions, and interest expense. Deductions also are allowed for medical expenses in excess of 5 percent of adjusted gross income (AGI), casualty losses in excess of 10 percent of AGI, and for miscellaneous other expenditures, including costs of earning income not deducted elsewhere. The Treasury Department proposal will phase out completely the deduction for all state and local taxes. Charitable contributions will be deductible only to the extent they exceeded 2 percent of adjusted gross income; the deduction of charitable contributions by non-itemizers will be eliminated. The deduction for a charitable donation of appreciated property will be limited to the indexed basis. The existing deduction for medical expenses in excess of 5 percent of AGI and casualty losses in excess of 10 percent of AGI will be left intact. The deduction for mortgage interest on the taxpayer's principal residence will be unchanged, but the deductibility of other personal interest expense will be reduced and limited for taxpayers with substantial interest expense in excess of realized capital income. Miscellaneous expenses of earning income will be combined with employee business expenses and made an "above-the-line" adjustment, rather than an itemized deduction; this combined deduction will be limited to the excess of such expenses over 1 percent of adjusted gross income. Placing this floor under itemized deductions for employee expenses will simplify compliance for many taxpayers and allow rates to be lowered further than if all expenses could be deducted.

The Bradley-Gephardt proposals will retain the deduction for state and local taxes on income and real property, but eliminate itemized deductions for all other state and local taxes. The proposals will retain the itemized deductions for interest on home mortgages, but will substantially limit deductions for other personal interest. The itemized deductions for charitable contributions and for casualty and theft losses will be retained, but that for medical expenses will be limited to expenditures in excess of 10 percent of adjusted gross income.

Under the Bradley-Gephardt approach itemized deductions could be used only in calculating tax under the 14 percent rate; they will not be deductible against the 12 percent and 16 percent surtaxes that raise marginal rates to 26 percent and 30 percent. By allowing itemized deductions only for purposes of computing income taxed at the 14 percent rate, the Bradley-Gephardt plan effectively converts

itemized deductions into 14 percent tax credits. This approach limits the tax value of deductible expenses to the same dollar amount for all taxpayers. If the purpose of the deduction is to provide a subsidy through the tax system, this approach is satisfactory. However, to the extent that itemized deductions help define economic income properly subject to tax, the full deduction should be allowed in computing income for purposes of the surtaxes as well.

Under the Kemp-Kasten approach itemized deductions will be retained for interest on home mortgages and on educational loans, but not on other consumer debt, for state and local property and general sales taxes, for charitable contributions, and for medical expenses in excess of 10 percent of adjusted gross income and for casualty and theft losses. The deduction for state and local income taxes will be eliminated.

#### **D. Tax Abuses**

Some taxpayers improperly take business deductions for expenses that most Americans would view as personal expenses. In addition, various techniques are used by some taxpayers to shift income from themselves to their children, who are in lower tax brackets. For example, parents can transfer income-earning assets to their children or they can establish trusts that enable income to be subject to tax rates lower than those of the parents. Provisions in the Treasury Department proposal will prevent the claiming of business deductions for personal expenses and will limit the benefits of income shifting. Neither the Bradley-Gephardt proposal nor the Kemp-Kasten plan addresses these issues.

#### **E. Simplification**

The increases in the personal exemptions and zero-bracket amounts and the limitations on the availability of itemized deductions will simplify tax compliance for many Americans. With lower tax rates taxpayers will have less incentive to find deductible expenditures and because fewer deductions are available, they will have less need for recordkeeping.

**1. The return-free system.** Because of its increased capability of processing withholding and information returns, the Internal Revenue Service will soon have improved capability of calculating tax liabilities for many Americans. As a result, the Treasury Department is proposing that the United States begin to test a "return-free system," under which many individual taxpayers will be relieved of the obligation of filing an income tax return. Instead, for taxpayers who certify that they only had certain sources of income and deductions, the Internal Revenue Service will send the taxpayer a report of tax calculation based on information at its disposal. The taxpayer will then either accept the IRS report or indicate that additional information will require filing of a regular return. Initially, eligibility for the return-free system will be limited to taxpayers who had only wages subject to withholding and interest income subject

to information reporting. Thus, an estimated 20 percent of returns to be filed by non-itemizers in 1988 might rely completely on returns originally prepared by the Internal Revenue Service. None of the other proposals for tax reform and simplification include a return-free system.

**2. Other simplification.** The Bradley-Gephardt and Kemp-Kasten proposals share some of the simplification advantages of the Treasury proposals, but they leave intact many provisions that involve complexities for taxpayers. The Treasury Department proposals will repeal the credit for political contributions, the Presidential campaign checkoff, special 10-year averaging for lump-sum distributions, and the 3-year rule for recovery of retirement contributions. It will eliminate (or allow to expire) all existing tax credits, other than the foreign tax credit, the credit for research and experimentation, and the earned income tax credit. It will simplify the tax treatment of pensions, it will unify and simplify existing penalties, and it will unify the substantive rules for the taxation of gifts and estates. The Bradley-Gephardt and Kemp-Kasten proposals would also eliminate most tax credits and the special 10-year averaging for lump-sum distributions. These plans generally do not address the tax treatment of pensions or the substantive rules for the taxation of gifts and estates, or alter tax penalties. The Treasury Department proposal will retain income averaging, except for those who have been students during the base period. Both the Bradley-Gephardt and Kemp-Kasten plans will repeal income averaging in its entirety.

## **II. Basic Taxation of Capital and Business Income**

Under current law capital and business income is subject to vastly different tax treatment, depending on its source. An important objective of the Treasury Department proposals is to make the tax treatment of business and capital income more uniform. This will allow business decisions to be based more on economic reality, and less on tax implications. Cutting corporate rates will further reduce the distortion of business decisions caused by the tax system.

### **A. Corporate Tax Rates**

Under current law the marginal rate of tax paid on corporate income increases with the amount of income, reaching a maximum of 46 percent at an income of \$100,000. The Treasury Department proposals will replace this graduated rate structure with a flat rate of 33 percent applied to all corporate income, including real capital gains of corporations. The Treasury Department proposals will retain the corporate minimum tax through 1992 and then phase it out over a three-year period, if most tax preferences are eliminated as proposed. The Bradley-Gephardt proposals will levy a 30 percent corporate rate and eliminate the corporate minimum tax. The Kemp-Kasten proposals will also subject most corporate income to a rate of 30 percent, but it will retain the corporate minimum tax, limit the tax rate on the first \$50,000 of corporate income to 15 percent, and apply a 20 percent rate to capital gains of corporations.

### **B. Investment Tax Credit**

The Treasury Department, as well as Bradley-Gephardt and Kemp-Kasten, proposes that the investment tax credit (ITC) be eliminated. The Treasury Department proposes repeal of the ITC because 1) the proposed system of capital recovery will compensate for inflation directly; 2) the current ITC discriminates against new businesses and companies with losses; 3) the ITC is a major source of tax shelter formation; and 4) administration of recapture rules with respect to the ITC is quite difficult and subject to abuse. At current low rates of inflation, moreover, the investment tax credit distorts resource allocation and it will continue to do so if retained in the proposed system. Rate reduction provides a uniform incentive for all corporations, and is therefore preferable to devices such as the investment tax credit, which is targeted to industries that are heavy producers or users of only the certain types of capital that benefit from the credit. Both the Bradley-Gephardt and Kemp-Kasten proposals will eliminate the credit for research and experimentation. The Treasury Department proposals will retain this credit, but restructure it to make it more effective.

### **C. Income Measurement: Inflation Adjustment**

During periods of high inflation the current income tax causes capital income to be overstated and it causes interest deductions to be exaggerated. The result is misallocation of the nation's capital and undesirable incentives for borrowing and disincentives for saving. Current law reflects efforts to avoid these distortions and inequities by allowing recovery of capital more rapidly than it actually depreciates and by excluding part of nominal capital gains. These ad hoc adjustments are appropriate only for given rates of inflation. On the other hand, no adjustment is made for the effect of inflation in the calculation of costs of goods sold from inventories or for overstatement of interest income and expense resulting from inflation.

The Treasury Department proposes to ameliorate these problems by allowing explicit inflation adjustment for depreciable assets, inventories, interest income and expense, and the calculation of capital gains. With the measurement of income improved by these adjustments for inflation, the ad hoc adjustments for depreciable assets and capital gains will no longer be needed. Thus, depreciation deductions can be made to correspond more closely to economic depreciation and capital gains can be taxed as ordinary income. Expensing would, however, be allowed for the first \$5,000 of depreciable business property. The deduction of capital losses will continue to be limited. The Treasury Department proposal will exclude from taxation a portion of interest income and disallow deduction of part of interest expense in excess of that on business indebtedness and mortgages on the taxpayer's principal residence, plus \$5,000. The fraction of interest income and expense to be ignored in calculating taxable income will depend on the rate of inflation.



The Kemp-Kasten proposal also includes indexation of the basis of capital gains and taxation of all capital gains of individuals as ordinary income, but it does not include inflation adjustment of depreciable assets. (It will continue the present Accelerated Cost Recovery System and the presently suspended ability of firms to expense up to \$10,000 of assets each year.) The combination of inflation adjustment for capital gains and continued ad hoc adjustment of depreciation allowances could create technical difficulties and unforeseen misallocation of economic resources. Moreover, the failure to index the cost of goods taken from inventories will continue the present tax discrimination against inventory-intensive industries. The Kemp-Kasten proposal will allow unlimited capital losses. It attempts to deal with the artificial minimization of taxes that is possible when losses on some assets may be recognized even though gains on other assets need not be recognized by treating capital losses as a preference item to be subject to the alternative minimum tax.

The Bradley-Gephardt proposal eliminates the distinction between long-run and short-run capital gains by subjecting all nominal gains to taxation as ordinary income. This approach leaves the effective rate of taxation of real capital gains dependent upon the rate of inflation. As during the 1970s, effective rates could far exceed the statutory rate; they could go above 100 percent, and tax could be collected on real losses. Taxing nominal gains as ordinary income could create substantial disincentives for investment, invention and innovation, particularly in periods of high inflation. The Bradley-Gephardt proposal will apply 250 percent declining balance depreciation to assets classified under the Asset Depreciation Range System of depreciation, with no adjustment for inflation. As a result, it will be much too generous at low inflation rates, but not generous enough at high inflation rates. The Bradley-Gephardt approach will not index inventories or adjust the amount of interest to be included in income or allowed as an expense.

All three proposals retain the rollover of capital gains on a principal residence: the Treasury Department and Kemp-Kasten proposals retain the \$125,000 one-time exclusion of gains on the principal residence; the Bradley-Gephardt proposal does so only for the purpose of computing income subject to tax at the 14 percent rate.

#### **D. Retirement Savings**

All three proposals leave intact the present tax treatment of individual retirement accounts (IRAs) and Keogh plans (retirement accounts for the self-employed). The Treasury Department proposal will make IRAs of spouses working in the home without pay subject to the same limits as those of employed taxpayers and raise the limit on tax-free contributions to IRAs.

All three proposals essentially leave intact the present tax treatment of qualified pension plans and profit-sharing plans. To achieve administrative simplicity, the Treasury Department proposals

will eliminate the combined limits on amounts contributed to defined benefit and defined contribution plans which are not top-heavy, but will impose an excise tax on the receipt of extraordinarily large benefits after retirement. The Bradley-Gephardt proposal, by comparison, nearly halves the limits under present law. Under the Kemp-Kasten proposal, the current limits will be retained. The Treasury Department proposals will unify various other provisions, including penalties for premature withdrawals by employees.

#### **E. Neutrality Toward the Form of Business Organization**

Under present law corporations and partnerships are subject to substantially different tax treatment. Partnerships, regardless of their size or other features, are taxed as pass-through entities; that is, there is no tax at the partnership level, and all income or losses are simply passed on to individual partners for inclusion in their tax returns. As a result, partnerships are used as important vehicles for tax shelters, since they allow individuals to take deductions for partnership losses against income earned from other sources. In the case of large partnerships, pass-through treatment can create severe collection and other administrative costs. In the event of a partnership audit, collection notices must be sent to the hundreds or thousands of individual taxpayers who were owners of the partnership at the time the original, erroneous return was filed. Some of these taxpayers may have moved, some may be in substantially different circumstances, some may have died, and some may have sold their interests to others. Income earned by corporations, on the other hand, is subject to double taxation; corporate profits are taxed as earned and then dividends paid from after-tax income are taxed again when received by shareholders. One objective of the Treasury Department's study has been to make more consistent the treatment of partnerships and corporations which closely resemble one another.

The Treasury Department proposals will provide a more consistent treatment of similarly situated corporations and partnerships through 1) the reclassification of certain partnerships as corporations for tax purposes, and 2) the reduction of the double tax on dividends paid. The reclassification proposal involves treating as a corporation any limited partnership that includes 35 or more limited partners. In addition, corporations will be allowed a deduction for part of dividends paid. The dividends paid deduction will eliminate part of the double taxation of dividends, since the part of dividends allowed as a deduction to the corporation will be taxed only at the shareholder level.

Neither the Bradley-Gephardt nor the Kemp-Kasten proposals deal with the important issue of unification of the tax treatment of partnerships and corporations. The Treasury Department and Bradley-Gephardt proposals will repeal both the personal holding company tax and the rules for collapsible corporations. The Bradley-Gephardt proposal repeals the accumulated earnings tax; the Treasury Department

proposes to retain it. All three proposals will repeal the small exclusion for dividends received by shareholders (\$100 for single and separate returns; \$200 for joint returns).

### III. Industry-Specific Subsidies, Tax Shelters, and Other Tax Issues

#### A. General Issues of Income Measurement

Because certain provisions of current law do not take adequate account of the timing of income receipts and payments, taxation of income can be deferred until future years. This tax deferral lowers the effective tax rate on the tax-preferred activity, distorts the allocation of investment across industries, and causes similarly-situated taxpayers to be treated differently.

Current tax rules do not match taxable receipts and deductions for activities that require several years to produce. Matching can be achieved if the costs of producing assets are capitalized, that is, included in the basis of the asset and recovered (deducted) when the asset is sold or when the basis is depreciated. The rules requiring capitalization of expenses incurred in the construction of capital assets are incomplete and vary by type of activity. This treatment distorts the choice between purchased and self-constructed assets and encourages tax shelters in multiperiod production activities.

Under the Treasury Department proposals the capitalization rules will be reasonably comprehensive of all expenses and will be uniform across activities. The other proposals will extend 10-year amortization of construction period interest and taxes to other business assets, but are not as comprehensive as the Treasury proposal.

Under current law the gain on installment sales is not taxed until payments are received. Under the Treasury Department proposal, a taxpayer will not be entitled to use the installment sales method if the installment obligations are converted into cash by means of pledging or other arrangement, thereby eliminating the taxpayer's possible liquidity problem. The other two proposals do not change current law in this area.

Under current law, taxpayers can generally elect to use either the cash or accrual methods of accounting. Although the accrual method of accounting is considered to be a more accurate measure of annual economic income, the cash method is administratively simpler for certain taxpayers. The option to use different accounting methods allows taxpayers to reduce taxes artificially by mismatching recognition of taxable income and deductions. The Treasury Department proposal will require the use of the accrual method by all large firms, by all firms using the accrual method for financial reporting, and by firms holding inventories. The other two proposals do not address this issue. The other two proposals will require accrual accounting for farming and timber where the taxpayer has gross receipts greater than \$1 million.

The preferential tax treatment of bad debt losses encourages lenders to make risky loans and favors debt over equity financing. The Treasury Department proposal will remove these distortions by repealing the deduction for additions to reserves for bad debt loan losses and limiting the bad debt loss deduction to the amount of the current loan losses. The Treasury Department proposal will apply to both financial and non-financial institutions. The other two proposals will change allowances for bad debt loan losses only for financial institutions.

With these modifications of tax law, taxable income will resemble much more closely economic income. Ultimately, the present corporate minimum tax will be unnecessary and eventually it should be eliminated. It should be retained, however, over an interim period during which previously made investments continue to benefit from preferences allowed under current law. Whereas the Bradley-Gephardt proposal will also eliminate the corporate minimum tax, the Kemp-Kasten proposal will retain it.

## **B. Subsidies for Specific Industries**

The Treasury Department proposals will repeal numerous preferential cost recovery provisions designed to favor one form of investment over another, or one industry over another. These special provisions operate as subsidies, altering economic decisions. Such subsidies are justified only if the subsidy corrects appropriately an otherwise incorrect market evaluation of costs and benefits. None of the subsidies to be repealed can be justified on these grounds. Moreover, since the subsidy they provide is in the form of exclusion of income from tax, or as tax deferral, these provisions unfairly benefit higher-income investors more than lower-income ones.

**1. Energy and Natural Resources.** Under the Treasury Department proposals expensing of intangible drilling costs in the oil and gas industry will be replaced by depreciation allowances, and percentage depletion will be replaced by cost depreciation. Indexing of the basis of non-depleted resources will be allowed. The Treasury Department proposal will also accelerate the phase-out of the windfall profit tax to 1988. The Bradley-Gephardt and Kemp-Kasten proposals will also eliminate percentage depletion, expensing of exploration and development costs, and the deduction for intangible drilling costs, replacing them with ordinary depreciation. The Bradley-Gephardt and Kemp-Kasten proposals, however, will retain the windfall profit tax.

Under current law additions to reserves for strip mining reclamation can be deducted currently even though no expenditure has occurred. This tax treatment accelerates deductions for future expenses and lowers strip mining operators' effective tax rates through tax deferral. The Treasury Department proposal will require reclamation expenses to be deductible when the expenses have been paid or economic performance has occurred. The other two proposals do not change current law.

**2. Financial institutions.** Under current law various types of financial institutions (banks, thrift institutions, life insurance companies, and casualty insurance companies) are accorded a wide variety of preferential tax treatment. In effect, they are regulated through tax provisions that discourage competition. Besides discriminating in favor of investment in these institutions, relative to other investment alternatives, this patchwork treatment of preferences prevents the achievement of fair and neutral taxation, even within the financial sector. The Treasury Department proposals will make uniform the tax treatment of various types of financial institutions and generally subject income earned in the financial sector to the same tax law applied elsewhere in the economy. The Treasury Department proposals will repeal special exclusions, deductions and tax rates for the different financial institutions, require discounting of banks' bad debt loss reserves and casualty insurance company reserves, and restrict life insurance company reserves to the increase in policyholders' cash surrender value. The other two proposals will only change the special bad debt deductions of commercial banks and thrift institutions.

**3. Insurance investment income.** The exclusion of investment income ("inside" buildup) on life insurance policies and annuities is one of the major excluded sources of income. Interest income on savings held with other financial institutions is subject to tax whether or not the interest is currently distributed to the taxpayer. The tax-preferred treatment of the inside buildup encourages individuals to save through life insurance companies and perhaps to purchase life insurance that they would not buy except to gain access to the favorable tax treatment. All three proposals will tax the annual investment income earned on life insurance policies and annuities.

**4. State and local debt and investments.** Interest on debt issued by state and local governments (often called municipal bonds) has long been exempt from Federal income tax. In recent years the generally accepted exemption for general obligation bonds has been extended by state and local governments to "private purpose" activities -- activities such as home mortgages, educational institutions, hospitals, and industrial development projects -- that might more appropriately be financed entirely from local funds, or through private credit markets without Federal exemption for interest. In an attempt to limit these abuses, the Deficit Reduction Act of 1984 includes a limit of \$150 per capita on issuance of private purpose obligations by any state and its subdivisions. Even worse, some state and local governments have used proceeds from their securities to engage in tax arbitrage, by investing them in private or Federal debt obligations that pay rates of interest in excess of the municipal bond rate because they are subject to Federal tax. Each state and locality is encouraged to engage in as much of these activities as possible, since the cost is borne primarily by taxpayers in other states and localities. The result is an unproductive increase in Federal tax rates and shift in burdens of taxation between states. Residents of

jurisdictions with cautious or conservative borrowing habits are especially penalized.

The Treasury Department proposals will repeal the tax exemption of interest on private purpose bonds issued by state and local governments and tighten the restrictions on tax arbitrage and advance refunding related to tax-exempt bonds. Both the Bradley-Gephardt proposal and the Kemp-Kasten proposal will repeal the exemption of interest on private purpose obligations.

**5. Other specific subsidies.** Among the subsidies the Treasury Department proposals and both congressional bills will repeal are: the business energy production and alcohol fuel credits; the complex Capital Construction Fund mechanism to subsidize investment in fishing vessels and inland waterway and ocean going ships; expensing of capital expenditures for farmland conditioning and soil and water conservation; and 7-year amortization of capital outlays for forestation and reforestation.

The Treasury Department and Bradley-Gephardt proposals, but not the Kemp-Kasten proposal, will repeal provisions allowing 5-year amortization of investment in the rehabilitation of low-income housing and certified pollution control facilities installed in pre-1976 plants.

The Treasury proposals, but neither the Bradley-Gephardt nor the Kemp-Kasten proposals, will repeal the special favorable rule for deducting costs of future mine reclamation expenditures, the 5-year amortization of costs of registering trademarks and tradenames, and the 50-year amortization of investment in, and sunk costs of, railroad grading and tunnel bores.

### **C. Further Curtailment of Tax Shelters**

Many taxpayers use tax shelters to reduce their current tax liability. Even though many tax shelters are perfectly legal, they distort the allocation of economic resources and undermine both the equity of the tax system and the perception of fairness. Many of the Treasury Department, Bradley-Gephardt, and Kemp-Kasten proposals discussed above will make investing in tax shelters much less attractive. Important examples include reform of depreciation rules and changes in the tax treatment of capital gains. All three proposals will limit the deduction for interest expense. To further curtail the attraction of tax shelters, the Treasury Department proposal will extend the at-risk rules for loss deductions to real estate. Both the Treasury Department proposals and the Bradley-Gephardt proposal will repeal the alternative minimum tax; the Kemp-Kasten proposal retains it.

### **D. International Issues**

Income earned abroad by foreign subsidiaries of U.S. corporations is generally not subject to U.S. tax unless repatriated as dividends.

U.S. tax imposed on such dividends and on the earnings of foreign branches can be offset by a credit for taxes paid to foreign governments. The foreign tax credit is limited to the effective rate of U.S. tax paid on the foreign source income in question. Under current law companies are allowed to pool income and credits from all countries (though not from all sources) in calculating the limit on the foreign tax credit. In order to encourage U.S. exports, U.S. firms are allowed to establish Foreign Sales Corporations, the income from which benefits from tax deferral, even if distributed.

The Treasury Department and Kemp-Kasten proposals will continue the deferral of taxation of income from subsidiaries of domestic corporations. By comparison, the Bradley-Gephardt proposal will eliminate deferral. The Treasury Department proposal will require calculation of the limitation of the foreign tax credit on a country-by-country basis, in order to prevent an artificial incentive for American firms operating in high tax countries to invest in low-tax countries, rather than in the United States. Neither the Bradley-Gephardt nor Kemp-Kasten proposals address this issue. The Treasury Department proposal will continue the preferential treatment of Foreign Sales Corporations. The Treasury Department proposal also deals with certain problems in the measurement and determination of source of income; the Bradley-Gephardt and Kemp-Kasten proposals do not do so. The Treasury Department proposal will modify the possessions tax credit. The Bradley-Gephardt proposal will repeal the possessions tax credit, whereas the Kemp-Kasten proposal will retain it in its current form. The Treasury Department and Kemp-Kasten proposals will retain the exclusion for income of Americans working abroad; the Bradley-Gephardt proposal will repeal this exclusion.

#### **IV. Other Tax Issues**

##### **A. Taxation of Transfers**

Because the bases of the estate and gift taxes are calculated differently, current law favors those who can afford to make lifetime gifts over those who need or desire to retain their property until death. The preference given to lifetime gifts has also caused complex and arbitrary rules for including in the donor's estate certain previously transferred property. The Treasury Department proposal will treat transfers more uniformly by imposing the gift tax on the same basis as the estate tax. This change will simplify transfer taxation by eliminating the need for the rules that include certain gifts in an estate. The Treasury Department proposals will also simplify the rules for generation-skipping transfers and the rules that allow the estate tax to be made in installments where the estate has insufficient liquid assets to pay the tax. The other two proposals generally do not change the substantive rules for the taxation of transfers.

**B. Expiring Provisions**

The Treasury Department proposes elimination (or the allowance of currently planned expiration) of all major tax credits other than the earned income tax credit, the foreign tax credit, the credit for the elderly, blind, and disabled, and the credit for research and experimentation. The Kemp-Kasten proposals will reduce the earned income credit and retain the foreign tax credit and will repeal the credit for the elderly and the disabled, for research and experimentation credit, and all major tax credits. The Bradley-Gephardt proposal will retain the foreign tax credit and the earned income credit, but will repeal the credit for the elderly and the disabled, the credit for research and experimentation and all major tax credits.

All three proposals will repeal or allow to expire the special treatment for dividend reinvestment in public utility stock. All three plans will repeal or allow to expire the exclusions for employer-provided legal services and transportation. The Treasury Department proposal and the Bradley-Gephardt proposals will also repeal or allow to expire the exclusion of employer-provided legal and educational assistance.



## Appendix 8-A

COMPARISON OF TREASURY PROPOSAL WITH CONGRESSIONAL TAX REFORM BILLS

TREASURY DEPARTMENT (TD)		BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
<b>I. INDIVIDUAL INCOME TAXES</b>						
<b>A. <u>Rate Reduction</u></b>	3 rates: 15%, 25% 35% <u>1/</u>	3 rates: 14%, 26%, 30% <u>2/</u>	25% of taxa- ble income. Exclusion for 20% of wages in FICA tax base <u>3/</u>	4 rates: 12, 20, 30, & 34 on taxable income <u>4/</u>	10% of taxable income <u>5/</u>	19% of compensation <u>6/</u>
<b>B. <u>Fairness for Families</u></b>						
<b>1. Zero bracket amount. <u>7/</u></b>						
a. Single returns.	\$ 2,800	\$ 3,000	\$ 2,700	\$ 2,400	\$ 0	\$ 4,100
b. Married (joint return).	3,800	6,000	3,500	3,550	0	6,700
c. Married (separate return).	1,900	3,000	1,750	1,775	0	4,100
d. Head of household return.	3,500	3,000	2,700	2,400	0	6,000
<b>2. Personal exemptions. <u>8/</u></b>						
a. Taxpayer.	\$ 2,000	\$ 1,600 <u>9/</u>	\$ 2,000	\$ 1,050	\$ 2,000	0
b. Dependent (each).	2,000	1,000	2,000 <u>10/</u>	1,050	2,000 <u>11/</u>	\$ 810
c. Blind and elderly (each).	0	1,000	2,000	0	0	0
<b>3. Tax-free amount excluding the earned income credit (1986 levels)</b>						
a. Single returns	\$ 4,800	\$ 4,600	\$ 5,130 <u>12/</u>	\$ 3,610	\$ 2,090	\$ 4,470
b. Joint returns						
Family of 2	7,800	9,200	8,180 <u>12/</u>	5,920	4,180	7,310
Family of 4	11,800	11,200	12,540 <u>12/</u>	8,120	8,360	9,070
Family of 6	15,800	13,200	16,900 <u>12/</u>	10,320	12,540	10,830
c. Head of household returns						
Family of 2	7,500	5,800	7,310 <u>12/</u>	4,710	4,180	7,430
Family of 4	11,500	7,800	11,670 <u>12/</u>	6,910	8,360	9,190
Family of 6	14,500	9,800	16,030 <u>12/</u>	9,110	12,540	10,950
<b>4. Provide a single credit for the elderly, blind, and disabled to replace the exemptions for the elderly and the blind.</b>		Repeals credit for elderly and disabled	Repeals credit for elderly and disabled	Repeals credit for elderly and disabled	Repeals credit for elderly and disabled	Repeals credit for elderly and disabled

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
5. Repeal deduction for two-earner married couples.	Yes	Yes	Yes	Yes	Yes
6. Indexation of zero bracket amount, personal and dependents exemptions and dollar amounts of earned income credit (EITC).	No	Yes. Also reduces EITC.	Yes. Also increases EITC.	Indexation. Repeals EITC.	Yes. Repeals EITC.
7. Replace child and dependent care credit with a deduction from gross income with cap on allowable expenses.	Yes <u>13/</u>	Repeals credit	Repeals credit	Repeals credit	Repeals credit

C. Fair and Neutral Taxation

1. Excluded Sources of Income

1. Repeal exclusion of health insurance above a cap.	Limits exclusion <u>14/</u>	No	Limits exclusion <u>14/</u>	Repeals exclusion	No <u>15/</u>
2. Repeal exclusion of group-term life insurance.	Yes <u>16/</u>	No	No <u>16/</u>	No	No <u>15/</u>
3. Repeal exclusion of employer-provided death benefits.	No	No	Yes	Yes	No <u>15/</u>
4. Repeal exclusion of dependent care services or reimbursement.	Yes	No	Yes	Yes	No <u>15/</u>
5. Repeal special treatment of cafeteria plans.	Yes	No	Yes	Yes	No <u>15/</u>
6. Repeal exemption of voluntary employee's beneficiary associations and trusts for supplemental unemployment compensation and black lung disability.	No	No	No	No	No
7. Repeal special provisions regarding incentive stock options.	No	No	No	No	No <u>15/</u>
8. Repeal exclusion of military compensation with offsetting adjustments in military pay. mustering out pay.	No	No	Limited repeal of military tax-free allowances	Limited repeal of military tax-free allowances	No <u>15/</u>
9. Repeal exclusion of rental allowances or rental value of minister's home.	No	No	Yes	Yes	No <u>15/</u>

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
b. Wage replacement payments					
1. Repeal tax-exempt threshold for unemployment insurance compensation.	Yes	Yes	Yes	Yes	No
2. Repeal tax exemption of workers' compensation payments, black lung, and certain veterans' disability payments, but make such income eligible for the credit for the blind, elderly, and disabled.	No Repeals credit.	Repeals exemption for certain disability payments. Repeals credit.	Repeals exemption for certain disability payments. Repeals credit.	Exempts disability payments. Repeals credit.	Repeals exemption and credit.
c. Other excluded sources of income					
1. Repeal exclusion of scholarships and fellowships in excess of tuition.	Yes	Yes	Yes	No	No
2. Repeal exclusion of awards and prizes.	No	No	No	No	Yes
2. Preferred uses of income.					
a. Repeal itemized deduction for state and local taxes:					
1. State and local real property taxes.	No <u>13/</u>	No	Yes	No	Yes
2. State and local personal property taxes.	Yes	No	Yes	No	Yes
3. State and local income taxes.	No <u>13/</u>	Yes	Yes	No	Yes
4. State and local general sales taxes.	Yes	No	Yes	No	Yes
b. Repeal the above-the-line deduction for charitable contributions.	No <u>13/</u>	No	No	No	Yes <u>17/</u>
c. Limit deductions for charitable contributions to those in excess of 2 percent of gross income.	No <u>13/</u>	No	No	No	No <u>17/</u>
d. Limit deduction of charitable contributions of appreciated property to the indexed basis.	No	No	No	No	No <u>17/</u>
e. Repeal 50% and 30% limits on individual contributions.	No	No	No	No	No <u>17/</u>

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
f. Repeal 10% limit on corporate contri- butions (but retain 5% limit in certain cases).	Amends deduction <u>18/</u>	No	No	No	No <u>17/</u>
D. <u>Tax Abuses</u>					
1. Business Deductions for Personal Expenses					
a. Deny all entertainment expenses including club dues and tickets to public events except for business meals furnished in a clear business setting. Limit deduction for business meals on a per meal per person basis.	No	No	No	No	No <u>19/</u>
b. Limit deductions for meals and lodging away from home in excess of 200 percent of the Federal per diem. When travel lasts longer than 30 days in one city, limit deductions to 150 percent of the Federal per diem (and disallow incidental expenses).	No	No	No	No	No <u>19/</u>
c. Establish bright-line rules to separate indefinite and temporary assignments at 1 year.	No	No	No	No	No <u>19/</u>
d. Extend foreign travel rules for allo- cation of expenses between personal and business expenses to all travel.	No	No	No	No	No <u>19/</u>
e. Deny any deduction for travel as a form of education.	No	No	No	No	No <u>19/</u>
f. Deny deductions for seminars held aboard cruise ships.	No	No	No	No	No <u>19/</u>
g. Deny any deduction for travel by ocean liner, cruise ship, or other form of luxury water transportation above cost of otherwise available business trans- portation with medical exception.	No	No	No	No	No <u>19/</u>
2. Income Shifting					
a. Revise grantor trust rules to elimi- nate shifting of income to lower-rate beneficiaries through trusts in which the creator retains an interest.	No	No	No	No	No <u>21/</u>

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
b. During lifetime of creator, tax trust at creator's marginal rate, and allow deductions only for non-discretionary distributions and set-asides. After creator's death, tax all undistributed trust or estate income at top marginal rate.	No	No	No	No	No <u>21/</u>
c. Tax unearned income of children under 14 at the parent's tax rate (to the extent that such income exceeds the child's personal exemption).	No	No	No	No	No <u>21/</u>
d. Revise income taxation of trusts.	No <u>20/</u>	No <u>20/</u>	No	No	No
<u>E. Further Simplification</u>					
1. Non-filing system, in which IRS would compute tax for many taxpayers.	No	No	No	No	No
2. Repeal individual minimum taxes.	Yes	No	Yes	Yes	Yes
3. Move miscellaneous deductions above the line, combine with employee business expenses and make subject to a floor.	No <u>13/</u>	No	No	No	No
4. Repeal preferential treatment of capital gains.	Yes	Yes, for individuals.	Yes	No	Yes
5. Repeal political contribution credit.	Yes	Yes	Yes	Yes	Yes
6. Repeal presidential campaign checkoff.	No	No	No	No	Yes
7. Repeal deduction of adoption expenses for children with special needs, and replace with a direct expenditure program.	Repeals deduction only	No	Repeals deduction only	Repeals deduction only	Repeals deduction only
8. Disallow income averaging for taxpayers who were full-time students during the base period.	Repeals income averaging	Repeals income averaging	Repeals income averaging	No	Repeals income averaging
9. Repeal \$100/\$200 exclusion of dividend income.	Yes	Yes	Yes	Yes	Yes
<u>F. Other Miscellaneous Reforms</u>					
1. Increase limits on moving expenses.	No	No	No. Repeals deduction	No	No. Repeals deduction

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
2. Special rule for allowing deduction of some commuting expenses of workers who have no regular place of work.	No	No	No	No	No
II. BASIC TAXATION OF CAPITAL AND BUSINESS INCOME TAX					
A. <u>Lower Corporate Tax Rate</u>					
1. Reduce maximum corporate rate to 33%.	30%	30% above \$50,000	Retains current law	Retains current law	19% of business taxable income
2. Repeal graduated corporate rate structure.	Yes	No. 15% to \$50,000	Retains current law	Retains current law	Yes
3. Repeal personal holding company tax.	Yes	Yes	No	No	Yes
B. <u>Taxing Real Economic Income</u>					
1. Index capital gains and tax as ordinary income.	No indexation: tax as ordi- nary income <u>23/</u>	Indexation: Tax as ordi- nary income for indi- viduals <u>24/</u>	No indexation: Tax as ordi- nary income <u>25/</u>	Retains current law. <u>26/</u>	No indexa- tion: Tax as ordinary income
2. Index depreciation for inflation and set depreciation allowances to approximate economic depreciation.	Modified ADR: no inflation adjustment	ACRS: no inflation adjustment	Current law for corps. Expensing for certain equip- ment for individuals.	Retains current law for corps. Repeals allowances for individuals.	Expensing
3. Repeal investment tax credit.	Yes	Yes	Retains for corps. only	Yes, except for corps.	Yes
4. Repeal collapsible corporation rules.	Yes	No	No	No	No
5. Allow expensing of the first \$5,000 of depreciable business property but repeal legislative increases in that dollar limit.	No	No	No <u>27/</u>	No	No
6. Allow indexed FIFO and repeal conformity requirement.	No	No	No	No	No
7. Index interest receipts and payments in excess of mortgage interest plus \$5,000.	No	No	No	No	No

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
C. <u>Retirement Savings.</u>					
1. Raise IRA limits to \$2,500.	No	No	No <u>28/</u>	No	No
2. Make IRAs available to both employees and spouses working in the home.	No	No	No <u>28/</u>	No	No
3. Subject all tax-favored retirement plans (TFRP's) to uniform distribution rules.	No	No	No	No	No <u>29/</u>
a. Subject all pre-retirement distributions from TFRP's to a 20 percent premature distributions tax, generally, and 10 percent for tuition and first home purchase.	No	No	No	No	No <u>29/</u>
b. Subject all TFRP's to uniform minimum distribution rules.	No	No	No	No	No <u>29/</u>
c. Repeal 10-year averaging for lump-sum distribution.	Yes	Yes	Yes	No	No <u>29/</u>
d. Eliminate special recovery rules for qualified plan distributions.	No	No	No	No	No <u>29/</u>
e. Repeal special treatment for distributions of employer securities.	No	No	No	No	No <u>29/</u>
4. Simplify the deduction, contribution, and benefit limits for TFRP's.					
a. Repeal aggregate-based deduction limits for profit-sharing and stock bonus plans.	No	No	No	No	No <u>29/</u>
b. Subject excess contributions to a 6 percent excise tax to recapture excessive tax benefits.	No	No	No	No	No <u>29/</u>
c. Repeal combined plan limit for non-top-heavy plans.	No <u>30/</u>	No	No	No	No <u>29/</u>
d. Subject all retirement distributions in excess of \$112,500 per year to a 10 percent excise tax.	No	No	No	No	No <u>29/</u>
5. Miscellaneous changes.					
a. Extend deduction limits for TFRP's to ESOP's, and repeal the ESOP credit.	Repeals ESOP credit only.	Repeals ESOP credit only.	No	No	No <u>31/</u>

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
b. Repeal "cash and deferred arrangements"	No	No	No	No	No <u>29/</u>
c. Postpone deduction for interest on debt incurred to finance employee contributions to TFRP's until taxable distributions are made.	No	No	No	No	No <u>29/</u>
D. <u>Neutrality Toward the Form of Business Organization</u>					
1. Reduce double taxation of distributed corporate equity income by allowing a 50 percent dividend deduction.	No	No	No	No	No <u>22/</u>
2. Require that all partnerships with more than 35 partners be taxed as corporations.	No	No	No	No	No
III. INDUSTRY-SPECIFIC SUBSIDIES, TAX SHELTERS, AND OTHER ISSUES					
A. <u>General Issues of Income Measurement</u>					
1. Match expenses and receipts from multiperiod production.	No <u>32/</u>	No <u>32/</u>	No	No	No
2. Restrict use of cash accounting method.	Yes: limited to farming (including timber)	Yes: limited to farming (including timber)	No	No	No
3. Limit bad debt deductions to actual loan losses.	No	No	No	No	No
4. Disallow installment sales treatment when receivables are pledged.	No	No	No	No	No
5. Repeal corporate minimum tax.	Yes	No	No	No	Yes
B. <u>Subsidies for Specific Industries</u>					
1. Special rules for energy and natural resource industries.					
a. Repeal windfall profit tax.	No	No	No	No	No
b. Repeal percentage depletion; replace with cost depletion adjusted for inflation.	Yes: replace with depre- ciation	Yes: replace with depre- ciation	No	Repeals, except for corps.	No <u>33/</u>



TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
c. Repeal expensing of intangible drilling costs.	Yes	Yes	No	Repeals, except for corps.	No <u>33</u> /
d. Repeal expensing of qualified tertiary injectant expenses.	Yes	No	No	Repeals, except for corps.	No <u>33</u> /
e. Repeal expensing of hard mineral exploration and development costs.	Yes	Yes	No	Repeals, except for corps.	No <u>33</u> /
f. Repeal special treatment of coal, oil and timber royalty income.	Yes	Yes, except for corps.	No	No	Yes
g. Repeal special rules for mining reclamation reserves.	No	No	No	Repeals, except for corps.	No <u>33</u> /
h. Repeal nonconventional fuel production tax credit, alcohol fuel credit, and excise tax exemption.	Repeals credits	Repeals credits	Repeals credits, except for corps.	Repeals credits, except for corps.	Repeals credits
2. Special Rules of Financial Institutions					
a. Commercial banks and thrift institutions.					
1. Repeal special bad debt deductions for banks and thrift institutions.	No <u>34</u> /	No <u>34</u> /	No	No	No
2. Disallow 100% of interest incurred to carry tax-exempt bonds by depository institutions.	No	No	No	No	No
3. Repeal tax exemption of credit unions.	Yes	No	No	No	Yes
4. Repeal special carryover rules and special merger rules of thrift institutions.	No	No	No	No	No
b. Life insurance companies					
1. Limit life insurance reserve deductions to the increase in policyholders' cash surrender value.	No	No	No	No	No
2. Repeal special deduction of percentage of taxable income for life insurance companies.	No	No	No	No	No

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
3. Repeal tax exemption for certain insurance companies.	No	No	No	No	No
c. Property and casualty (P&C) insurance companies					
1. Limit P&C reserves to the discounted present value of future liabilities.	No	No	No	No	No
2. Repeal mutual P&C insurance companies' deduction for additions to protection against loss accounts.	No	No	No	No	No
3. Limit deductibility of P&C policyholder dividends.	No	No	No	No	No
4. Repeal special tax exemption, rate reductions, and deductions of small mutual P&C insurance companies.	No	No	No	No	No
3. Insurance Investment Income					
a. Repeal exclusion of annual income on life insurance policies.	Yes	Yes	No	No	Yes <u>35/</u>
b. Treat policyholder loans as coming first from any tax-exempt inside buildup.	No	No	No	No	No
c. Repeal exclusion of current annuity income.	Yes	Yes	No	No	Yes
4. State and Local Government Debt and Investment					
a. Repeal the tax exemption of private purpose tax-exempt bonds.	Yes	Yes	No	No	No
b. Tighten restrictions on tax arbitrage and advance refunding for tax-exempt bonds.	No	No	No	No	No
5. Repeal special expensing and amortization rules.					
a. Repeal expensing of soil and water conservation expenditures, expenditures by farmers for fertilizer and for clearing fields.	Yes	Yes	No	Repeals, except for corps.	No
b. Repeal 5-year amortization of expenditures for rehabilitation of low income rental housing.	Yes	No	No	Repeals, except for corps.	No <u>33/</u>

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
c. Repeal 5-year amortization of certified pollution control facilities.	Yes	No	No	Repeals, except for corps.	No <u>33</u> /
d. Repeal 50-year amortization of railroad grading and tunnel bores.	No	No	No	Repeals except for corps.	No <u>33</u> /
e. Repeal 5-year amortization of trademark expenses.	No	No	No	Repeals, except for corps.	No <u>33</u> /
f. Repeal 84-month amortization of reforestation expenditures and 10 percent tax credit for such expenditures.	Yes	Yes	No	Repeals, except for corps.	No <u>33</u> /
7. Other specific subsidies.					
a. Repeal rehabilitation tax credits.	Yes	Yes	Yes, except for corps.	Yes, except for corps.	Yes
b. Tighten rules for depreciating leasehold improvements.	No	Repeals	No	Repeals, except for corps.	No
c. Repeal special rules for returns of magazines and paperback books and for qualified discount coupons.	Yes	No	No	Repeals, except for corps.	No
d. Repeal exclusion relating to Merchant Marine Capital Construction Fund.	Yes	Yes	No	No	No
e. Rationalize credit for research and experimentation.	Repeals credit	Repeals credit	No	Repeals, except for corps.	Repeals credit
<u>C. Further Curtailment of Tax Shelters</u>					
1. Disallow most current deductions for schedule A interest in excess of sum of home mortgage interest, investment income, and income from limited partnerships and S corporations plus \$5,000.	Allows deduction for home mortgage interest. Limits deduction for consumer interest. <u>36</u> /	Allows deduction for home mortgage interest. Limits deduction for consumer interest. <u>37</u> /	Allows deduction for home mortgage interest. Disallows deduction for consumer interest.	Retains current law.	Repeals interest deduction including home mortgage interest.
2. Extend limits on interest deduction where taxpayer is not at risk to real estate and equipment leasing.	No	No	No	No	No

TREASURY DEPARTMENT (TD)	BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)	
D. <u>International Issues 38/</u>						
1. Change foreign tax credit limitation to a separate per-country limitation.	No	No	No	No	No	
2. Modify rules defining source of income derived from sales of inventory-type property and intangible property.	No	No	No	No	No	
3. Repeal the secondary dividend rule and replace with a branch profits tax.	No	No	No	No	No	
4. Repeal special preference for 80/20 corporations.	No	No	No	No	No	
5. Clarify treatment of foreign exchange gains and losses.	No	No	No	No	No	
6. Repeal possessions tax credit and replace with a phased out wage credit.	Repeals credit	No	No	No	Repeals credit	180
E. <u>Other Tax Issues</u>						
1. Transfer Taxation						
a. Unify estate and gift tax structure by grossing up the tax on gifts, and simplify rules for determining when a transfer is complete for gift tax purposes.	No	No	No	No	No	
b. Simplify taxation of generation-skipping transfers, and modify credit for tax on prior transfers to a lower generation.	No	No	No	No	No	
c. Impose a rule to prevent abuse of minority discounts.	No	No	No	No	No	
d. Replace the rules governing payment of estate tax in installments with simplified rules based on estate liquidity, but make interest incurred by an estate non-deductible for estate tax purposes.	No	No	No	No	No	

TREASURY DEPARTMENT (TD)	1BRADLEY- GEPHARDT (B-G)	KEMP- KASTEN (K-K)	ROTH- MOORE (R-M)	NICKLES - SILJANDER (N-S)	DECONCINI- SHELBY (D-S)
e. Reduce estate tax deduction for claims against an estate by the amount of income tax savings from payment of the expense.	No	No	No	No	No
f. Simplify state death tax credit and gift tax rate and credit by making it a flat percent of Federal estate tax collected.	No	No	No	No	No
g. Repeal special tax rules for redemption of stock to pay death taxes.	No	No	No	No	No
h. Tighten rules regarding powers of appointment	No	No	No	No	No
2. Penalties <u>39/</u>					
a. Simplify information return penalties.	No	No	No	No	No
b. Repeal maximum limits on penalties.	No	No	No	No	No
c. Replace failure to pay penalty with a cost-of-collection charge.	No	No	No	No	No
3. Expiring provisions					
a. Residential and certain business energy tax credits.	Repeals	Repeals	Yes, except for corps.	Repeals	Repeals
b. Targeted jobs credit.	No stated proposal	Repeals	No stated proposal	Repeals	Repeals
c. Expensing of expenditure to remove architectural barriers to the elderly and handicapped.	No stated proposal	No stated proposal	No stated proposal	No stated proposal	Allows expensing <sup>33</sup>
d. Credit for testing orphan drugs.	Repeals	Repeals	Repeals, except for corps.	Repeals, except for corps.	Repeals
e. Special treatment for dividend reinvestment in public utility stock.	Repeals	Repeals	Repeals	No stated proposal	Repeals
f. Exclusion of employer-provided legal services.	Repeals	Repeals	Repeals	Repeals	No stated proposal <u>15/</u>
g. Exclusion of employer-provided education assistance.	Repeals	No stated proposal	Repeals	Repeals	No stated proposal <u>15/</u>
h. Exclusion of employer provided vanpooling.	Repeals	Repeals	Repeals	Repeals	No stated proposal <u>15/</u>

# FOOTNOTES

- 1/ For single returns the 15 rate would apply to taxable income above \$2,800, the 25 percent rate to taxable income above \$19,300, and the 35 percent rate to taxable income above \$38,100. For joint returns the 15 percent rate would apply to taxable income above \$3,800, the 25 percent rate to taxable income above \$31,800, and the 35 percent rate to taxable income above \$63,800. For head of household returns the 15 percent rate applies to taxable income above \$3,500, the 25 percent rate to taxable income above \$25,000 and the 35 percent rate to taxable income above \$48,000.
- 2/ 14% of taxable income; surtax of 12% on adjusted gross income (AGI) in excess of \$40,000 or \$25,000 for joint and single returns, respectively; surtax of 16% on AGI's in excess of \$65,000 and \$37,500 for joint and single returns, respectively. Heads of households would be treated like single individuals. The maximum rate would be 30%. Itemized deductions, personal exemptions, and the deductions for charitable contributions and child care expenses can only be used to calculate the tax subject to the 14 percent rate.
- 3/ If earned income is less than \$15,000 for a married couple or \$10,000 for a single person, 20% of total income may be excluded up to \$10,000 or \$15,000. Exclusion phases out at the rate of 12.5 cents per dollar of income in excess of the FICA wage base.
- 4/ These rates apply when the proposal is fully phased -in (1990 and thereafter).
- 5/ In N-S, taxable income of individuals excludes alimony, social security benefits, disability income, state and local bond income, railroad retirement benefits, and certain Federal retirement benefits.
- 6/ In D-S compensation is defined as cash wages. Non-cash fringe benefits are excluded from compensation.
- 7/ Estimated current law values for 1986 are \$2,510, \$3,710, \$1,850, and \$2,510 for single returns, joint returns, separate returns, a/nd head of household returns, respectively. The ZBAs are at 1986 levels for TD, 1984 levels for KK, 1985 levels for R-M, 1984 levels for N-S, and 1983 levels for D-S.
- 8/ Estimated current law value for 1986 is \$1,090. The exemptions are at 1986 levels for TD, 1984 levels for KK, 1985 levels for R-M, 1983 levels for D-S.
- 9/ B-G provides head of households an exemption of \$1,800.
- 10/ K-K would disallow dependency exemptions for students over age 18.
- 11/ In N-S, dependency exemptions are limited to children, stepchildren under 18, full-time student dependents, and dependents with less than \$2,000 of income.
- 12/ The amount shown represents the total of the zero bracket amount plus the personal exemptions. Taxpayers could also exclude 20 percent of their earned income, up to the FICA wage base. Taxpayers with less than \$10,000 or \$15,000 of earned income for single and joint returns, respectively, could exclude 20 percent of their total income up to \$10,000 or \$15,000.
- 13/ In B-G, deductions can only be used to calculate the tax subject to the 14 percent rate.
- 14/ B-G and R-M limit the exclusion of employer contributions to accident and health insurance to amounts attributable to providing wage replacement payments.
- 15/ Under D-S individuals would exclude fringe benefits, but businesses would not deduct compensation in the form of fringes.
- 16/ B-G and R-M would repeal exclusion but only to the extent that employer paid premiums exceed employee paid premiums.
- 17/ D-S would repeal charitable deduction for both businesses and individuals.

- 18/ B-G would limit the deduction to 50 percent of contributions.
- 19/ D-S would allow a deduction for business travel and entertainment expenses, if reasonable.
- 20/ B-G would tax estate and trusts at a 30% rate. K-K would tax estates and trusts at a 25% rate.
- 21/ D-S would reduce the incentive for income shifting by taxing all income at the 19 percent rate.
- 22/ D-S would provide dividend relief by taxing corporate income only once at the corporate level.
- 23/ For purposes of computing the base tax, B-G would retain the one-time exclusion of \$125,000 of gain on the sale of a principal residence by taxpayers who are 55 years old or older. This exclusion would not apply for purposes of computing the surtaxes.
- 24/ K-K would reduce the capital gains tax rate to 20% for corporations. Capital losses would be deductible against ordinary income, but would be subject to the individual minimum tax. The one-time exclusion for \$125,000 of gain on the sale of a principal residence by taxpayers who are 55 or older would be retained.
- 25/ R-M would repeal the one-time exclusion of gain from sale or exchange of principal residence.
- 26/ N-S would repeal the one time exclusion of \$125,000 of gain on the sale of a principal residence for taxpayers 55 years old and older.
- 27/ R-M would allow individuals to expense certain equipment.
- 28/ R-M provides a new SUSA savings account with deductible annual limits of \$10,000 and \$20,000 for single and joint returns, respectively. Funds could be used for non-retirement purposes. Income earned on the account would be tax-exempt until withdrawn.
- 29/ D-S would disallow the deduction for contributions to pension plans and would treat pension contributions as compensation of the employee.
- 30/ B-G would reduce limits on qualified pension plans from \$30,000 on defined contribution plans and \$90,000 on defined benefit plans to \$15,000 and \$45,000, respectively.
- 31/ D-S does not have a specific proposal on TFRP's, but would repeal all tax credits.
- 32/ B-G and K-K would repeal expensing of interest and taxes paid during the construction of a building and would require that these costs be amortized over 10 years.
- 33/ D-S would permit expensing of capital costs.
- 34/ B-G and K-K would repeal the deduction for bad debt reserves for financial institutions in excess of their actual experience.
- 35/ Under the business tax, interest paid to customers of financial institutions would not be deductible.
- 36/ For purposes of computing the base tax, B-G would allow itemized deductions for home mortgage interest and nonbusiness interest to the extent of investment income. For purposes of computing the surtaxes, investment interest is deductible to the extent of investment income.
- 37/ K-K would allow deductions for interest on loans to pay educational expenses, but not for other consumer debt.
- 38/ B-G would repeal deferral of foreign source income, DISC, and the exclusion of income of Americans working abroad. K-K would repeal DISC. R-M would repeal the exclusion of income of Americans working abroad. D-S would not tax the foreign source income of U.S. citizens and corporations, but would tax the U.S. source income of foreigners.
- 39/ N-S contains a special tax amnesty provision which waives the criminal and civil penalties for tax underpayment for taxpayers who agree to certain conditions.

Appendix 8-B

**SUMMARY OF TAX REFORM BILLS**  
**INTRODUCED DURING THE 98TH CONGRESS**

H.R. 170, the Tax Simplification Act, was introduced by Mr. Hansen. The bill would tax the income of individuals, estates, and trusts at the rate of 15 percent. The deduction for personal exemptions would be increased to \$3,000. Most deductions and exclusions would be repealed, including those for medical expenses, capital gains, and IRAs. Itemized deductions would continue to be allowed for expenses attributable to the conduct of a trade or business and for the production of income, for charitable contributions to a church or a convention or association of churches, and for alimony payments. Tax credits would continue to be allowed. The bill would not amend the corporate income tax.

H.R. 542, the Flat Rate Tax Act of 1983, was introduced by Mr. Philip M. Crane. The bill would tax the income of individuals, estates, and trusts in excess of the deduction for personal exemptions at the rate of 10 percent. The allowance for personal exemptions would be increased to \$2,000 and would be indexed for inflation occurring after 1982. All exclusions, deductions, and credits would be repealed. The bill would not amend the corporate income tax.

H.R. 1664, the Flat Rate Tax Act of 1983, was introduced by Mr. Paul. The bill would tax the income of individuals, estates, and trusts at the rate of 10 percent. The personal exemptions would be increased to \$2,500. The bill would not amend the corporate income tax.

H.R. 1770, the Flat Tax Act of 1983, was introduced by Mr. Dreier. The bill would tax the gross income of individuals, estates, and trusts in excess of the deduction for personal exemptions at the rate of 14 percent. The allowance for personal exemptions would be increased to \$2,000. All exclusions, deductions, and credits would be repealed. The bill would not amend the corporate income tax.

H.R. 2137, the Flat Rate Tax Act of 1982, was introduced by Mr. Paul. The bill would tax the gross income of individuals, estates, and trusts in excess of \$10,000 at the rate of 10 percent. All exclusions, deductions, and credits for individual taxpayers would be repealed. The bill would not amend the corporate income tax.

H.R. 2520, the Income Tax Simplification Act of 1983, was introduced by Mr. Panetta. The bill would tax the income of individuals, corporations, estates, and trusts at the rate of 18 percent. For individuals, the bill would replace the standard deduction and the deductions for personal, blind and elderly exemptions with a tax credit. The credit for personal exemptions would be \$1,000 for a single return and \$2,000 for a joint return.



The credit for each dependent, the blind, and the elderly would be \$200 each. Most credits (except the foreign tax credit), exclusions, and deductions would be repealed, except for those that are related to the conduct of a trade or business or the production of income. Individuals would continue to be allowed to deduct alimony payments. The bill would repeal special rules that apply to natural resources industries, including the deduction for depletion and for intangible drilling and development costs, and special rules relating to insurance companies and banking institutions. The bill would also repeal deductions for certain entertainment expenses, and employer contributions to pension, stock bonus, profit-sharing or annuity plans. The bill would repeal the special tax treatment afforded Domestic International Sales Corporations and the exclusion of income of Americans working abroad. The special tax treatment of capital gains would be repealed, including the provisions that allow the rollover of gain on the sale of a home. Income averaging would be repealed.

H.R. 3271, the Fair Tax Act of 1983, was introduced by Mr. Gephardt. This bill is the same as S. 1421, introduced by Senator Bradley. The provisions of these bills are summarized in Appendix 8-A.

H.R. 3516, the Flat Rate Tax Act of 1983, was introduced by Mr. Don Young. The bill would tax gross income over \$10,000 at the rate of 15 percent. All exclusions, credits, and deductions would be repealed, except for the deductions for charitable contributions, home mortgage interest, and expenses incurred in carrying on a trade or business. The bill would not amend the corporate income tax. The bill would provide certain taxpayer protection standards that relate to the administration of the tax.

H.R. 4776, the Flat Rate Tax Act of 1984, was introduced by Mr. Quillen. The bill would tax the income of individuals, estates, and trusts at the rate of 10 percent. Exclusions would be repealed, except for social security benefits, veterans benefits, and interest on tax-exempt bonds. The allowance for personal exemptions would be increased to \$2,000. Other deductions would be repealed, except for charitable contributions, home mortgage interest and interest used to finance investment, state and local income and property taxes, and trade and business expenses. Tax credits would be repealed. The bill would not amend the corporate income tax.

H.R. 4871, introduced by Mr. Dannemeyer, directs the Treasury Department to propose legislation and provides guidelines that would be used to develop the legislation. All income of businesses and individuals would be taxed only once at a 15 percent rate. The poorest households would not pay income tax. Individual taxpayers would be allowed a deduction for personal and dependency exemptions, charitable contributions, and home mortgage interest. Capital gains would be exempt from tax. For the business tax, the distinction between corporations, partnerships, farms, and professionals would be removed. Deductions would be allowed for capital expenses, for the cost of goods and services, and charitable contributions.

H.R. 5432, the Ten Percent Flat Tax Rate Act, was introduced by Mr. Siljander. This bill is the same as S. 5432, introduced by Senator Nickles. The provisions of these bills are summarized in Appendix 8-A.

H.R. 5484, the Ten Percent Tax Rate Act, was introduced by Mr. Paul. The bill would tax the income of individuals at the rate of 10 percent. The personal exemptions would be increased to \$2,000. Certain exclusions would continue to be allowed, including alimony payments, scholarship and fellowship grants, supplemental security income, disability payments, government employee retirement benefits, interest on certain tax-exempt bonds, and fringe benefits. Deductions would continue to be allowed for trade and business expenses, and for expenses related to the production of income. Most other deductions would be repealed, including the deductions for medical expenses, alimony payments, taxes, and for two-earner married couples. All tax credits for individuals would be repealed. The estate and gift tax provisions would be repealed. The bill would not amend the corporate income tax.

H.R. 5711, introduced by Mr. Shelby, is the same as S. 557, introduced by Senator DeConcini. The provisions of these bills are summarized in Appendix 8-A.

H.R. 5841, the Progressive Consumption Tax Act of 1984, was introduced by Mr. Heftel. The bill would tax consumption of individuals at graduated rates that range from 10 percent to 50 percent. The consumption of corporations would be taxed at the rate of 30 percent. To compute taxable consumption, the taxpayer would add net income, any increase in debt, and any decrease in saving. From that total, the taxpayer would subtract any decrease in debt and any increase in savings. To compute net income the taxpayer would be allowed deductions for trade and business expenses, capital losses, certain expenses related to the production of income, moving expenses and alimony. Individuals could claim a standard deduction, equal to \$3,400 for joint returns and \$2,300 for single returns. A credit of \$200 would be provided for each personal exemption. Most credits, exclusions and deductions allowed under current law would be repealed. The deduction for interest would be limited to home mortgage interest, interest on debt used to purchase investment assets, and interest incurred in the active conduct of a trade or business. The deduction for charitable contributions would be limited to 5 percent of adjusted gross consumption. The deduction for medical expenses would continue to be allowed. Capital losses would be fully deductible. Casualty and theft losses in excess of \$500 would be deductible. The deduction for property taxes would be repealed. The gift tax would be repealed, but gifts would be includible in the recipient's gross income.

H.R. 6165, the Fair and Simple Tax Act of 1984, was introduced by Mr. Kemp. The this bill is the same as S. 2948, introduced by Senator Kasten. The provisions of these bills are summarized in Appendix 8-A. H.R. 6165 and S. 2948 replace H.R. 5533 and S. 2600, respectively.

H.R. 6364, the Broad-Based, Enhanced Savings Tax Act of 1984, was introduced by Mr. Moore. This bill is the same as S. 3042, introduced by Senator Roth. The provisions of these bills are summarized in Appendix 8-A.

H.R. 6384, the SELF-Tax Plan Act of 1984, was introduced by Mr. Schulze. This bill is the same as S. 3050, introduced by Senator Quayle. S. 3050 replaces S. 1040. Taxable income in excess of \$6,000 for single returns and head of household returns, and \$10,000 for joint returns would be subject to tax at graduated rates ranging from 15 percent to 30 percent. The personal exemption would not be increased. All tax credits for individuals would be repealed. Many exclusions for individuals would be repealed, including interest on certain state and local government bonds. The exclusion for scholarships and fellowships would be limited to tuition expenses. Many deductions for individuals would be repealed, including the deductions for casualty and theft losses, two-earner married couples, intangible drilling and development costs, and percentage depletion. Home mortgage interest would be deductible, but other consumer interest would not be deductible. Unemployment compensation and governmental welfare or assistance benefits would be taxable. Capital gains would be taxed like ordinary income. The bills would not amend the corporate income tax, but directs the Treasury Department to study certain corporate and individual income tax changes.

6420, the Cash Flow Income Tax Act of 1985, was introduced by Mr. Heftel. The bill would tax the income of individuals at graduated rates ranging from 10 percent to 30 percent. Income of corporations would be taxed at the rate of 30 percent. Income of estates and trusts in excess of \$3,000 would be taxed at the rate of 30 percent. Individuals would be allowed a standard deduction of \$8,000 for joint returns, \$6,000 for head of household returns, and \$4,000 for single returns. A nonrefundable credit equal to \$200 for each dependent would be permitted. Most other credits, exclusions, and deductions provided under current law would be repealed. To compute adjusted gross income, a taxpayer would add net income, any increase in debt, and any decrease in savings. From this total, the taxpayer would subtract any decrease in debt and any increase in savings. The taxpayer would be permitted to elect an exclusion of up to \$20,000 in debt. To compute net income, the taxpayer would be permitted deductions for trade and business expenses, foreign taxes, capital losses, certain expenses related to the production of income and alimony payments. Interest expenses for the purchase of investment assets and home mortgage interest would continue to be deductible, but consumer interest would not be deductible. The deduction for charitable contributions would be limited to 5 percent of adjusted gross income. The deduction for property taxes would be repealed. Deductions would be permitted for medical expenses in excess of 10 percent of adjusted gross income and for casualty and theft losses in excess of \$500. Capital losses would be fully deductible. Gifts and bequests in excess of \$5,000 per year would be includable in the recipient's gross income.

S. 1767, the Personal Income Tax Reform Act of 1983, was introduced by Senator Mitchell. The income of individuals, estates, and trusts would be subject to a base tax equal to 12 percent and a surtax that ranges from 8 percent to 24 percent. Personal exemptions would be increased to \$1,750 for a taxpayer who is the head of household, and \$1,500 for any other taxpayer. The amount of dependency exemptions would be \$1,000 each. The standard deduction would be increased to \$4,600 for joint returns. For all other returns, the amount would be \$2,300. Most of the exclusions, deductions, and credits contained in current law would be repealed. One-third of the employer's contribution to the employee's medical care plan would be included in the employee's income. Scholarship and fellowship grants in excess of tuition and related expenses would be included in income. The deductions for two-earner married couples and for adoption expenses would be repealed. For individual taxpayers, the capital gains exclusion and the distinction between short and long term capital gains are repealed. The deduction for interest would be allowed for home mortgage interest, interest on trade or business debt, and other interest subject to limitations. The credit for dependent care expenses would be replaced with an itemized deduction. The exclusion for the gain on the sale of a principal residence for a taxpayer who is 55 years old or older would be replaced with an itemized deduction. Individual retirement accounts, and qualified pension, profit-sharing, and stock bonus plans would be taxed at the rate of 12 percent. Income averaging would be repealed. The bill would not amend the taxation of corporations.

S. 2158, the Simpliform Tax Act, was introduced by Senator Hatfield. The bill would tax the income of individuals at graduated rates ranging from 6 percent to 30 percent. Joint returns would be eliminated. The standard deduction would be repealed and the personal and dependency exemptions would be replaced by credits equal to \$250 each. Most credits, deductions, and exclusions provided under current law would be repealed. Deductions would continue to be allowed for expenses related to the production of income, and for alimony payments. Certain deductions allowed under current law would be replaced by tax credits. A credit would be provided for 20 percent of qualified medical expenses in excess of 10 percent of adjusted gross income (AGI). A credit would be provided for home mortgage interest equal to 15 percent of the interest paid in excess of one percent of AGI, up to a maximum credit of \$1,000. A credit would also be provided for 20 percent of charitable contributions in excess of one percent of AGI, and for 15 percent of state and local taxes in excess of one percent of AGI, up to a maximum credit of \$1,000. The bill would repeal the partial exclusion of capital gains and would index the basis of assets for determining capital gains and losses. The bill would not amend the corporate income tax, but directs the Treasury Department to conduct a study of amendments to the corporate income tax that would lower the rate of tax, eliminate tax preferences, and structure the corporate tax in a way that is similar to the individual income tax provided in the bill.